Pathological Foreign Investment Projects in China: Patchwork or Trendsetting by the Supreme People’s Court?

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Abstract

As of March 2010, almost 690,000 foreign invested enterprises had been established on the Chinese mainland. During the first eight months of 2010 alone, the foreign investment volume on the Chinese mainland amounted to US$65.95 billion, marking an increase of 18.1% year on year. Despite these impressive numbers, foreign investment projects in China often encounter difficulties. In May 2010, the Supreme People’s Court of the People’s Republic of China adopted the Regulations on Several Issues Concerning the Trial of Cases of Disputes Related to Foreign Funded Enterprises (I), which entered into force on August 16, 2010. The Regulations address legal problems related to foreign investment projects in China. This article analyzes the practical impact of the Regulations against the background of the current status of China’s investment system.

I. Introduction

Foreign investments in mainland China have been constantly on the rise since the People’s Republic of China (P.R.C.) began to liberalize its markets in 1978. The global financial crisis has only caused a short set back with a speedy recovery since mid-2009. Between January and March 2010, mainland China’s GDP grew 11.9%, representing a 5.7% increase year on year. During the same period, Mainland China’s foreign invest-

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2. Id.
4. In this article the terms “mainland China” and “China” stand for the People’s Republic of China, excluding the Hong Kong Special Administrative Region, Macau Special Administrative Region, and Taiwan.
ment volume was US$23.44 billion up 7.7% from 2009.\textsuperscript{7} By March 2010, almost 690,000 foreign invested enterprises had been established on the Chinese mainland with a combined total investment volume of over US$1 trillion.\textsuperscript{8} During the first eight months of 2010, the foreign investment volume on the Chinese mainland amounted to US$65.95 billion, which was an increase of 18.1% year on year.\textsuperscript{9}

Despite these impressive numbers, foreign investment projects in China often encounter problems for various reasons. On May 17, 2010, the Supreme People’s Court of the People’s Republic of China (the “SPC”) adopted the \textit{Regulations on Several Issues Concerning the Trial of Cases of Disputes Related to Foreign Funded Enterprises (I)} (the “SPC Regulations”).\textsuperscript{10} The SPC Regulations entered into force on August 6, 2010.\textsuperscript{11} They address legal problems in a variety of areas arising in the context of foreign investment projects on the Chinese mainland. This article analyses the SPC Regulations critically in the context of the status quo of the Chinese investment system. Divided into three main parts, it first summarizes briefly the legal framework governing foreign investments in mainland China. The second part introduces the main sources of problems foreign parties have to face when investing in China. Against this background, the main part then discusses the SPC Regulations and their actual and potential impact in practice on foreign investment projects in mainland China.\textsuperscript{12} The final part of this article concludes with general observations and remarks regarding potential future developments in the area of Chinese investment law.

II. Mainland China’s Investment Law Regime

A. General

Foreign investment projects in China can be implemented in two different ways, namely as direct investment projects\textsuperscript{13} and through mergers and acquisitions (M&A). Foreign direct investment implies that the foreign investor establishes a new business entity in China from scratch either together with Chinese partners or as a 100% subsidiary.\textsuperscript{14} In an M&A project, the foreign investor buys into an already existing business or

\textsuperscript{7} Ren, \textit{supra} note 1.

\textsuperscript{8} Id.


\textsuperscript{10} Several Issues, \textit{supra} note 3.

\textsuperscript{11} Id.

\textsuperscript{12} Id. Art. 13 of the SPC Regulations addresses the use of equity interest in foreign invested enterprises as security. For the sake of allowing for a focused discussion of issues related to foreign investments in China, Art. 13 of the SPC Regulations and related issues will not be further discussed in this article.

\textsuperscript{13} The term “direct investment” will be used for investment projects that entail the establishment of a business in mainland China from scratch, rather than acquiring all or part of an already existing operation through mergers and acquisitions. The term “direct investment” is not, however, a technical term. Consequently, it is often used in different ways. In particular, it is sometimes used for any investment project, which does not entail the takeover of companies through the acquisition of listed shares.

\textsuperscript{14} For so-called “quasi asset deals,” where a Chinese party contributes part of its existing business to a newly established joint venture, see \textit{Lutz-Christian Wolff, Mergers and Acquisitions in China: Law & Practice} 104 (3d. ed. 2009) [hereinafter \textit{Wolff 2009}].
merges one business with another.\textsuperscript{15} China's investment system was initially based on the direct investment model and foreign investment strategies were mostly implemented through the direct investment route. In contrast, M&A projects are a rather new phenomenon.\textsuperscript{16}

Foreign investments on the mainland are still restricted in many ways and it has been claimed in recent times that the investment environment is worsening for foreign investors.\textsuperscript{17} In particular, China's rather new merger control system\textsuperscript{18} and the introduction of an \textit{Indigenous Innovation Product Accreditation Programme}\textsuperscript{19} have been considered and criticized in this context. While there is no hard evidence that China's investment regime takes a more protectionist approach than those of other countries, it is obvious that contrary to the situation during the 1980s and 1990s, China no longer needs to receive foreign investments in whatever form and at whatever price.\textsuperscript{20} By contrast, the Chinese government rather tries to channel investments into special areas of need, i.e. first and foremost in hi-tech industries.

B. DIRECT INVESTMENT

As mentioned,\textsuperscript{21} foreign parties are not free to set up business in mainland China. Among others, foreign investors have to use dedicated investment vehicles, normally referred to as foreign investment enterprises (FIEs). The three most commonly used FIE types are equity joint ventures, cooperative joint ventures, and wholly foreign owned enterprises.

Laws supporting the establishment and operation of equity joint ventures (EJVs) had been enacted as early as in 1979,\textsuperscript{22} with related Implementing Rules\textsuperscript{23} and numerous rules and regulations on more specific aspects since then. EJVs are jointly established by foreign and Chinese parties who have to make capital contributions in cash or in kind.\textsuperscript{24} The

\textsuperscript{15} Cross-border mergers are not a common investment tool in the Chinese context. \textit{See id.} at 157-58.
\textsuperscript{16} Id. at 2.
\textsuperscript{17} Ren, \textit{supra} note 1.
\textsuperscript{18} Some issues, such as the Anti-Monopoly Law's requirement of a "state security check" of all foreign-related M&A deals, have drawn special attention. Anti-Monopoly Law (promulgated by the Standing Comm. Nat'l People's Cong., Aug. 30, 2007, effective Aug. 1, 2008) \textsc{LawInfoChina} (last visited Oct. 24, 2010) (P.R.C.). Unclear details have lead to concerns that the authorities in charge may use discretionary powers to block foreign acquisitions in China whenever it is deemed appropriate on the basis of state security grounds. Paul Jones, \textit{China's New Anti-Monopoly Law: An Economic Constitution for the New Market Economy?}, 3 P.C.R. L. REP. 3, 8 (Sept. 2007).
\textsuperscript{19} The Program was unexpectedly announced in late 2009 and then apparently 'shelved' amid concerns voiced by foreign business entities and their representative organizations. Paul Mooney, \textit{Hurdles Get Higher For Foreign Firms}, S. CHINA MORNING POST, May 16, 2010, at 12.
\textsuperscript{21} Id.
\textsuperscript{23} Id.
\textsuperscript{24} Certain Company Laws apply as long as FIE laws do not offer special regulations; cash contributions shall not be less than thirty percent of the registered capital, i.e. the contributions to be made by the FIE parties excluding third-party financing. Company Law, art. 18, 27 (promulgated by the Standing Comm. Nat'l People's Cong., Oct. 27, 2005, effective Jan. 1, 2006) \textsc{LawInfoChina} (last visited Oct. 24, 2010) (P.R.C.); Opinions on Implementing Issues Related to Law Application in Examination and Approval and
25. Such as the so-called “registered capital.”
26. Total investment may include registered capital plus third-party financing. For the ratio, see the Interim Provisions Concerning the Proportion of Registered Capital and Total Amount of Investment of Sino-Foreign Equity Joint Ventures, which also apply to other FIE types and are supplemented by numerous industry specific rules. Interim Provisions Concerning the Proportion of Registered Capital and Total Amount of Inv. of Chinese-Foreign Equity Joint Ventures (promulgated by the State Admin. for Indus. & Commerce, Feb. 17, 1987, effective Feb. 17, 1987) INVESTMENr VEHICLES, MERGERS AND Acquisitions, AND CORPORATE FINANCE IN CHINA 20081.
29. In practice, approval authorities may ask for much higher capitalization based on viability arguments. Company Law.
30. Equity Joint Ventures Law art. 6; Equity Joint Venture Implementing Rules, supra note 28, art. 30.
31. Equity Joint Ventures Law arts. 6, 8; Equity Joint Venture Implementing Rules, supra note 28, arts. 31, 76.
34. KUEI-KUO WANG, WANG’S BUSINESS LAW OF CHINA 251 (1999); STAMFORD L. CORP., MERGERS AND ACQUISITIONS IN CHINA 41 (2006); CHENGWEI LIU, CHINESE COMPANY AND SECURITIES LAW: INVESTMENT VEHICLES, MERGERS AND ACQUISITIONS, AND CORPORATE FINANCE IN CHINA 44 (2008).
Joint Venture Law in 1988 and by related Implementing Rules much later in 1995. While many of the EJV rules and regulations in practice applied also in relation to CJVs, at least in theory, CJVs remain more flexible than EJVs. In particular, CJVs allow for profit distribution among the CJV partners and representation on the highest CJV organ according to contract terms, i.e., not—as in the case of EJVs—strictly according to the capital ratios of the CJV parties. Also, the repatriation of the CJV-parties' capital contributions is possible under certain circumstances prior to the end of the CJV term. CJVs can be established as limited liability companies or in "other forms." In practice, CJVs are always established as limited liability companies.

Finally, foreign investors can establish 100% subsidiaries, i.e., so-called wholly foreign owned enterprises (WFOEs). Many of the original restrictions regarding the establishment and operation of WFOEs have been removed as a result of China's accession to the WTO. Like CJVs, WFOEs can be established as limited liability companies and in "other forms." If established only by one foreign investor the registered capitalization must be at least RMB 100,000 safe for special industry-related rules. WFOEs are nowadays the most popular foreign investment vehicle because they seem to allow an independent FIE operation without the need to coordinate with another partner or partners.

The establishment, any substantive changes, and the termination of EJVs, CJVs, and WFOEs are subject to the approval of the Ministry of Commerce ("MOFCOM") or its lower level units, depending on the investment volume and the particular industry within which the enterprise is to operate. After approval has been obtained, registration or de-
registration with the State Administration of Industry and Commerce ("SAIC") and other authorities is required. 47 Finally, investment projects may be subject to verification by the National Development and Reform Commission if certain preconditions are fulfilled. 48 Even today, it is not completely clear if foreign investors have a right to approval, registration, and verification if all the necessary formal requirements of an investment project have been fulfilled. 49

Apart from EJVs, CJVs, and WFOEs, foreign investors can also establish branches 50 and representative offices, 51 foreign invested joint stock companies, 52 and foreign invested partnerships. Special rules on the establishment and operation of foreign invested partnerships have just entered into force. 53 They have caused much interest—in particular in

47. CHENGWEI Liu, supra note 34, at 4.


49. WOLFF 2009, supra note 14, at 7.

50. The main legal basis for the establishment and operation of branches of foreign companies in China are found in the Company Law. Company Law, arts. 192-98, 213.


the funds industry—which, in line with international practice, anticipated the use of (limited) partnerships for funds structuring purposes. The establishment of foreign invested partnerships is not subject to MOFCOM approval. In contrast, SAIC registration is sufficient for the establishment. Whether this development justifies hopes that the approval requirement for investment projects will in the future be removed altogether is one of the questions to be answered on the basis of the below analysis of the SPC Regulations.

C. Mergers and Acquisitions (M&A)

As mentioned, China’s M&A market is rather young. As far as the legal framework governing China-related M&A projects is concerned, the first more comprehensive set of rules supporting foreign M&A transactions in China was enacted as late as 1997. Since then, China’s M&A market has grown significantly. During the first nine months of the year 2010 alone, 2,483 M&A deals were conducted on the Chinese mainland, reaching a volume of US$119 billion, which marks a 12.1% growth compared with 2009. Just recently, the State Council of the P.R.C. has reinforced the importance of the use of M&A tools to restructure the domestic industry by publishing the Opinions on Promoting the Merger, Acquisition and Restructuring of Enterprises.

China’s M&A legal regime is rather complex due to the fact that it has not been established in a coherent and structured way. In contrast, a large number of rules and regulations have been enacted with differing and partly overlapping scopes of application at different times and levels whenever this seemed to be needed. Different rules are, for example, in force that cover, respectively, the acquisition of FIE equity interest, the acquisition of equity interest in Chinese companies without foreign investment as well as asset deals, FIE mergers, takeovers of listed companies, the acquisition of state-owned enterprises, and M&A projects in dedicated industry sectors. Special rules for so-

56. As mentioned above in Section II(A).
57. Rules and regulations regarding the establishment and operation of FIEs only provided some very basic rules and regulations on mergers and acquisitions. Equity Joint Venture Implementing Rules, supra note 28, art. 23.
called round-trip investments, i.e. investments where a Chinese party sets up business abroad to re-invest in mainland China as an artificial foreign investor complement the diversified M&A regime on the Chinese mainland.\(^6\) In addition, in cases where any pre- or post-deal entity qualifies as FIE, the rules governing the establishment, operation, and termination of FIEs must be observed.\(^6\)

As in the case of direct investment projects,\(^6\) all foreign-related M&A transactions are in principle subject to MOFCOM approval, SAIC registration, and NDRC verification.\(^6\)

III. Problems Encountered when Investing in Mainland China

According to a study conducted in 2006, seventy to eighty percent of foreign investment projects are discontinued during the due diligence stage. In these cases, the investor(s) decided not to pursue the project even prior to signing.\(^6\) In contrast, the failure rate internationally is normally as low as twenty to thirty percent.\(^7\) While this can be seen as evidence of pre-operational investment problems in the Chinese market, problems often continue after closing.

The causes of pre- and post closing FIE problems can be very different. First, one has to realize that China's investment law regime is still in the process of constant development to match the ongoing economic reforms. Laws and regulations are often enacted to address specific problems that emerge at a particular point of time. As a result, China's legal system lacks coherence. Laws and regulations are often unclear, overlapping, or even contradicting each other.\(^7\) In addition, legislative gaps still exist in certain areas.\(^7\)

As a result, foreign investors and their advisors are often left in limbo as to what the law is and how authorities, courts, and other dispute settlement bodies will apply existing rules. One drastic example may demonstrate the problems:

On August 13, 2007, the National People's Congress adopted the PRC Anti-Monopoly Law, which entered into force on August 1, 2008.\(^7\) The merger control rules of the PRC
Anti-Monopoly Law require that the Ministry of Commerce ("MOFCOM") must be notified if transactions in the form of mergers, share or asset deals, or the acquisition of control over an enterprise through contractual tools or otherwise reach certain thresholds. The Anti-Monopoly Bureau of MOFCOM should, on the basis of the information submitted and—if deemed necessary—after discussions with the applicant, decide if the transaction affects the Chinese market negatively and if it should therefore be disallowed or only be allowed subject to conditions. The PRC Anti-Monopoly Law, however, fails to set the thresholds that trigger the notification requirement. Regulations that specify these thresholds entered into force on August 3, 2008, supplemented by special provisions for the finance industry on August 15, 2009. Prior and even after the entering into force of the PRC Anti-Monopoly Law, investors could therefore only guess which projects required notification and were therefore at risk of not being approved.

Foundational documents of FIEs, established in particular during the eighties and the nineties of the past century, often mirror the technical problems of China’s investment law system. When not properly drafted, they result in incomplete or inappropriate contractual frameworks, which complicate rather than facilitate the operation and termination of the respective FIE.

Implementation problems add to the difficulties. First, as investment laws and regulations are often unclear, the implementation practice of approval authorities is sometimes inconsistent, making it difficult to assess in advance how Chinese in a particular case will be treated. In practice, informal discussions between foreign investors in China and concerned authorities are therefore mandatory to ensure compliance with local usage. Second, foreign investors, by FIEs, and also by mainland authorities, do not always strictly comply with investment rules and regulations. One case may serve as an example: A foreign FIE party had to transfer its equity interests to one of its subsidiaries to prepare for a global restructuring exercise. The general manager of the FIE reported the successful transfer and provided a copy of the amended FIE approval certificate and of the FIE’s business license. Both documents showed that the holder of equity interest was...
indeed a company that carried the name of the subsidiary. Only the due diligence conducted as part of the global restructuring exercise revealed that in reality no transfer of FIE equity interest had ever taken place. Instead, the FIE's general manager had somehow been able to convince the approval and registration authorities that the foreign investor had changed its name and that the FIE approval certificate and business license should be amended accordingly. Correcting the situation caused tremendous problems as it meant a great loss of face not only on the part of the general manager, but also on the part of the approval and registration authorities, as they had apparently not requested to be supplied with reliable evidence in support of the alleged name change of the foreign FIE party.

Finally, enforcement of related rights has long been a problem due to the lack of proper legal training of government officials, judges, and arbitrators, but has improved over the past decade. Furthermore, improper motives and factors, such as local protectionism, lack of judicial independence, or even corruption and fraud can be reasons for administrative decisions, which are not supported by the legal framework. In recent years, Chinese lawmakers have put a lot of effort in attempts to improve the situation, but up to now, the efforts have only had limited success.

There are, of course, also non-law-related factors, such as cultural differences between Chinese and foreign parties or simply the fact that foreign investors are not familiar with the specifics of the mainland Chinese market, which may cause difficulties for foreign investment projects or even lead to their complete failure.

IV. The New SPC Regulations

A. General

The enactment of the SPC Regulations on August 16, 2010 can be seen as a promising attempt to address existing problems in the area of Chinese investment law. The SPC Regulations have been enacted as judicial interpretation based on the SPC Regulations on Judicial Interpretation (eff. Apr. 1, 2007), judicial interpretations can take different forms, namely the form of (i) an 'interpretation' for the concrete application of a law in relation to a special case or special types of cases, (ii) a 'regulation' for a normation, opinion or interpretation necessary for judicial decision finding, (iii) a 'reply' for judicial interpretations in response to a request by a court or military court for instructions regarding the application of a law, and (iv) a 'decision' if the amendment or annulment of a judicial interpretation is concerned. See also Several Reasons, supra note 3, art. 6.
Judicial Interpretation, the latest version of which has entered into force on April 1, 2007. Like other judicial interpretations adopted by the SPC since the mid-1980s, the SPC Regulations have a normative character with the goal of ensuring the consistent application and interpretation of laws and regulations. They therefore supplement the existing legal framework governing FIEs and FIE-related M&A projects, as discussed in sections II(A) and II(B). The SPC Regulations provide instructions to lower ranked courts as to how to deal with specific issues related to foreign investments on the Chinese mainland. It is without doubt, however, that their significance will not be limited to actual court cases. In contrast, the SPC Regulations will serve as guidelines for foreign and Chinese investors as to what to expect in related problem situations.

The SPC Regulations are expressly meant to "correctly try cases involving disputes arising out of the process of the establishment and alteration of foreign-invested enterprises." From the viewpoint of foreign investors, this expression could be seen as an unfortunate limitation of the applicability of the scope of applicability of the SPC Regulations as the acquisition by foreign investors of equity interest in a purely domestic enterprise without FIE status does not seem to be covered. It remains unclear if and why this might be the case.

As the title of the SPC Regulations indicates, they are the first interpretation of the SPC on issues related to FIE disputes, although more are expected to follow. The SPC has taken a similar approach in other areas, such as contract law and company law, where a sequence of interpretations has been issued.

The SPC Regulations consist of twenty-four articles covering topics of major practical importance related to direct investment, M&A, and the use of FIE equity interest as security. Apart from their significance from the viewpoint of China's investment regime,
the SPC Regulations are also interesting from a doctrinal point of view, as a number of the issues addressed concern fundamental contract law and property law questions.104 As of their date of effectiveness, the SPC Regulations are to be applied to future cases as well as to cases pending at the first and second court levels.105 But, in relation to cases where final judgment has been rendered already, the SPC Regulations shall remain unapplied in relation to any retrial.106 Under the P.R.C. legal doctrine, the Hong Kong Special Administrative Region, the Macau Special Administrative Region, and Taiwan are parts of the P.R.C. but have separate legal systems.107 Investors from these regions are therefore not 'foreign' in the technical sense.108 But in line with established P.R.C. investment law practice,109 Article 22 of the SPC Regulations expands their scope of applicability by analogy to disputes involving FIEs established by investors from these regions.110

B. Direct Investment

The SPC Regulations address a number of issues related to the establishment and operation of FIEs. First, they repeat111 that contracts concluded for the establishment of FIEs as well as contracts relating to changes of FIEs that are subject to an approval requirement shall become effective only upon the approval granted by the competent approval authority.112 Interestingly, the SPC Regulations also state that any contractual obligation to submit FIE-related documents for approval is to be regarded as valid even prior to the approval.113 The approval is therefore not mandatory for the formation of FIE-related contracts but only for the contract's effectiveness.114 The SPC Regulations also empha-

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105. The Chinese court system is based on the principle "four levels of courts and at most, two trials to conclude a case." CHEN, supra note 90, at 137-40.
106. Several issues, supra note 3, art. 23.
108. Id.
109. Id. at 1048.
110. See Several Issues, supra note 3, art. 22.
111. See supra, Sections II(B) and II(C).
112. See Several Issues, supra note 3, art. 22; see also Contract Law, art. 44 ¶ 2 (promulgated by the National People’s Congress, Mar. 15, 1999, eff. Oct. 1, 1999) ("If laws or administrative regulations provide for procedures such as approval or registration to be carried out before a contract becomes effective, such provisions shall govern.").
113. Several Issues, supra note 3, art. 1 ¶ 2.
114. See BING LING, CONTRACT LAW IN CHINA 100 (2002).
size that even approved FIE contracts agreements may be void\textsuperscript{115} or voidable\textsuperscript{116} according to other laws and regulations.\textsuperscript{117}

The SPC Regulations now also address the issue of so-called 'supplementary agreements,' i.e. agreements concluded by FIE parties relating to issues addressed in FIE foundational documents.\textsuperscript{118} Supplementary agreements are not uncommon in practice.\textsuperscript{119} They are used by FIE parties to make additional arrangements either after the FIE has already been established or upon its establishment for the purpose, e.g. not to disclose certain information to the approval authority or to make informal changes without going through the whole approval process again.\textsuperscript{120} The enforceability of supplementary agreements has always been questionable.\textsuperscript{121} The SPC Regulations now stipulate that these supplementary agreements are valid even without approval unless they constitute a 'significant or substantial change' to the respective FIE.\textsuperscript{122} Examples of significant or substantial changes are changes to an FIE's registered capital,\textsuperscript{123} to its corporate form or term, to the capital ratio of the FIE parties, to the mode of capital contribution,\textsuperscript{124} mergers and divisions of FIEs as well as the transfer of FIE equity interest.\textsuperscript{125} Unfortunately, this list of 'significant or substantial changes' provided by the SPC Regulations is not exhaustive.\textsuperscript{126} Courts therefore seem to have discretion to expand the list of 'significant or substantial' changes.\textsuperscript{127} This discretion will lead to uncertainty in practice.\textsuperscript{128}

Parties to FIEs have to make capital contributions in cash or in kind,\textsuperscript{129} i.e. to transfer respective property rights to the FIE in which they invest.\textsuperscript{130} In principle, Chinese law requires an agreement between transferor and transferee as well as delivery for the transfer of ownership rights regarding movable property.\textsuperscript{131} Registration is also required in rela-

\textsuperscript{115} Cf. Contract Law, art. 52 ("A contract shall be null and void under any of the following circumstances: (1) a contract is concluded through the use of fraud or coercion by one party to damage the interests of the State; (2) malicious collusion is conducted to damage the interests of the State, a collective or a third party; (3) an illegitimate purpose is concealed under the guise of legitimate acts; (4) damaging the public interests; (5) violating the compulsory provisions of laws and administrative regulations.").

\textsuperscript{116} Cf. Contract Law, art. 54 ("A party shall have the right to request the people's court or an arbitration institution to modify or revoke the following contracts: (1) those concluded as a result of significant misconception; (2) those that are obviously unfair at the time when concluding the contract.").

\textsuperscript{117} Several Issues, supra note 3, art. 3.

\textsuperscript{118} See id. art. 2 ¶ 1.

\textsuperscript{119} See Wolff 2008, supra note 32, at 1071-72.

\textsuperscript{120} See Wolff 2009, supra note 14, at 77.

\textsuperscript{121} Id.

\textsuperscript{122} Several Issues, supra note 3, art. 2.

\textsuperscript{123} For the term "registered capital," see Interim Provisions Concerning the Proportion of Registered Capital and Total Amount of Inv. Of Chinese-Foreign Equity Joint Ventures, supra note 26.

\textsuperscript{124} Several Issues, supra note 3, art. 2 ¶ 2.

\textsuperscript{125} Id.

\textsuperscript{126} See id.

\textsuperscript{127} See id.

\textsuperscript{128} See id.

\textsuperscript{129} For the allowable in-kind capital contribution ratio, see Company Law, art. 28. See also Opinions on Implementing Issues Related to Law Application in Examination and Approval and Administration of Foreign-Invested Companies' Registration, supra note 24.

\textsuperscript{130} For the development of the Chinese property law system, see Eva Pils, Chinese Property Law As An Image of PRC History, 39 HONG KONG LJ 595, 595-611 (2010).


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tion to the transfer of land use rights\textsuperscript{132} and to the transfer of building ownership.\textsuperscript{133} Article 4 of the SPC Regulations now stipulates that if an FIE party has failed to go through related registration procedures while the related property item has been delivered to and is in fact used by the FIE, then such party will be regarded as having performed its ownership transfer obligations as long as the registration is conducted within a time frame stipulated by a court.\textsuperscript{134} The FIE or the FIE parties are, however, entitled to reimbursement of any losses incurred as a result of the late registration.\textsuperscript{135} Here, the SPC apparently tries to take a practical approach by allowing the 'legalization' of factual situations that only lack completion of formal procedures.

C. M&A

As mentioned, FIE-related M&A transactions in China are subject to MOFCOM approval.\textsuperscript{136} Questions arise after the conclusion of an agreement regarding the transfer of FIE equity interest if the application for approval and the required transfer documents are not submitted to the competent approval authority.\textsuperscript{137} A contractual obligation to do so on the basis of the equity interest transfer agreement would only be for the transferor. In contrast, according to applicable statutory rules, it is the FIE which should submit the application for approval of the transfer of FIE equity interest to the approval authority.\textsuperscript{138} The SPC Regulations now bridge the gap between the contractual obligation of the transferor and the statutory obligation of the respective FIE by de facto extending the contractual obligation of the transferor to the FIE. They stipulate that when the transferor fails to obtain approval, the transferee can request a court to order the transferor and the FIE as "a third party" to go through the approval formalities jointly within a set time limit.\textsuperscript{139} Should the transferor and the FIE fail to apply for approval within the time limit set by the court, a court can also empower the transferee to apply for approval.\textsuperscript{140} Alternatively, if the transferor and the FIE fail to apply for approval even after having been urged to do so within a reasonable period of time, the transferee can also request a court to declare the FIE equity transfer agreement void and order the transferee to be reimbursed for any losses incurred.\textsuperscript{141}

In the event an FIE equity interest transfer agreement states that a price is to be paid by the transferee prior to the application for approval, and the transferee has failed to pay the

\textsuperscript{132} After the success of the Communist Revolution on the Chinese mainland in 1949, private ownership of land was abolished step-by-step. Since the late 1950s, collectives now own rural land, whereas the Chinese State now owns urban land. \textit{See} Nicholas C. Howson, \textit{The Law of The Land}, 22 CHINA BUS. REV. 40, 41 (1995) (in order to allow for a commercialization of real property, a system of land use rights was introduced after the start of the economic reforms in 1978).

\textsuperscript{133} \textit{See} Property Law art. 9; \textit{Wolff} 2009, supra note 14, at 100.

\textsuperscript{134} \textit{See} Several Issues, supra note 3, art. 4.

\textsuperscript{135} \textit{Id}.

\textsuperscript{136} \textit{Wolff} 2009, supra note 14, at 6-7.

\textsuperscript{137} Provisions for The Alteration of Investors' Equities, supra note 66, art. 9.

\textsuperscript{138} \textit{See} \textit{id}.

\textsuperscript{139} \textit{See} Several Issues, supra note 3, art. 6.

\textsuperscript{140} \textit{Id}.

\textsuperscript{141} \textit{See} \textit{id}, arts. 5-6.
price after having been urged to do so within a reasonable time period, the transferor can request a court to terminate the FIE equity interest agreement and to order the transferee to reimburse the transferor for any losses incurred.142

If, prior to the approval of an FIE equity transfer, the transferee has already started to participate in the management and operation of the FIE, the transferor can ask a court to order the transferee to withdraw from such management and operation and to forward to her all amounts received in connection with the management and operation according to Article 10 of the SPC Regulations.143 In this regard, the SPC Regulations seem to repeat the obvious, as in any event the transferee can obtain FIE party status only upon the FIE equity interest transfer agreement’s effectiveness, i.e. after approval.144

The transfer of FIE equity interest to a third party requires not only the conclusion of an FIE equity interest transfer agreement between transferor and transferee and approval.145 It is also mandatory to obtain consent of the other FIE parties146 and the unanimous endorsement of the FIE’s highest organ, i.e. normally the FIE’s Board of Directors ("BoD").147 In practice, this requirement has often caused difficulties for FIE parties who saw their attempts to exit an FIE project by disposing their FIE equity interest blocked by other FIE parties or those FIE parties’ representatives on the BoD who refused to grant the required consent or even requested to be "bought out." In practice, FIE parties have sometimes tried to address these potential difficulties proactively by stipulating in joint venture contracts at the time of the FIE establishment that each party agrees to any future transfer of FIE equity interest of a respective other party and that each party will cause the members of the BoD appointed by it to endorse the transfer. While I am not aware of any case where such a contract clause has been tested in court or during arbitration proceedings, it appears doubtful whether such a clause will be enforceable because the rules on FIE equity interest transfers have obviously not envisaged ex-ante approvals and consents of FIE-parties and BoD-members. In contrast, the legislative rationale seems to require ex-post decisions on the basis of the actual facts of the intended transfer.148

In a dramatic move, the SPC Regulations now seem to try to eliminate the possibility of FIE parties blocking the transfer of FIE equity by another.149 The SPC Regulations stipulate that in situations where the consent of another FIE party has not been obtained, such other FIE party can request a court to terminate the FIE equity interest transfer agreement.150 This request is only possible, however, if (i) the transferor has issued a written notice to the non-consenting FIE party in respect of the transfer, and such non-consenting FIE party has replied to the notice within thirty days, and (ii) the non-consenting FIE party does not refuse to purchase the related FIE equity interest from the transferor.151 This is a welcome development, as it seems to be intended to allow any FIE

142. See id. art. 9.
143. See id. art. 10.
144. Provisions for The Alteration of Investors’ Equities, supra note 66, art. 20.
145. See id. arts. 3, 9(6).
146. See id. art. 9(6).
147. See id.
148. For the use of offshore structures to address related problems, see WOLFF 2009, supra note 14, at 181-82.
149. See Several Issues, supra note 3, art. 12.
150. Id.
151. See id. art. 11.
party to dispose of its FIE equity interest by way of transferring it either to a third party or to a non-consenting FIE party.\textsuperscript{152} Details of this provision are, however, unclear, e.g., one can only assume that the written notice to be sent by the transferor to the other FIE parties is meant to inform such other FIE parties about the planned transfer and the specific conditions. Furthermore, the SPC Regulations only address the consent to be given by other FIE parties. In contrast, they fail to deal with the endorsement required from the highest FIE organ, i.e., in most cases the BoD. Since the BoD decision must be unanimous and BoD members are appointed by the different JV parties, it appears that FIE equity interest transfers to third parties could still be sabotaged by another FIE-party by way of causing its BoD representative to refuse to vote in favor of the deal. Finally, one can only assume that the conditions subject to which a non-consenting FIE party can purchase the FIE equity interest from the potential transferor should be the same as those offered to the third party. This, on the other hand, would mean that the non-consenting FIE party must \textit{de facto} exercise a preemptive right in relation to the related portion of the FIE equity interest to block the transfer to a third party as planned. The SPC Regulations do not, however, discuss this issue under the header of preemptive rights.

In contrast, the SPC Regulations address preemptive rights in a different provision stipulating that preemptive rights must be exercised within one year from the date on which the respective FIE party knew, or ought to have known, that the FIE equity interest transfer agreement has been signed.\textsuperscript{153} In the event that FIE equity interest has been transferred to a third party in violation of the preemptive right of another FIE party, such other FIE party can request a court to terminate the respective FIE equity interest transfer agreement.\textsuperscript{154} Preemptive rights are consequently strong weapons in the hands of all FIE parties. Therefore, to avoid any uncertainty in practice, the transferor of FIE equity interest should normally request an express waiver of any statutory\textsuperscript{155} and contractual preemptive rights to be declared by all other FIE parties together with the consent to the planned transaction.\textsuperscript{156}

If a party or the FIE uses improper means to apply to the approval authority to make 'changes to the FIE parties,' causing another FIE party to lose all or part of its FIE party status, the aggrieved party may apply to a court to be reinstated as an FIE party and to be reimbursed for any losses incurred.\textsuperscript{157} This possibility may only be excluded where a third party has already acquired the related FIE equity interest in good faith.\textsuperscript{158} One would assume that cases addressed by this rule are rather rare and that approval authorities would normally discover improper means used by foreign parties. However, legal reality on the Chinese mainland has proved this assumption to be wrong. The case reported above in Section II is just one example.

\textsuperscript{152} See id. arts. 11-12.
\textsuperscript{153} See id. art. 12.
\textsuperscript{154} Id.
\textsuperscript{155} See, e.g., Equity Joint Ventures Implementing Rules, supra note 28, art. 2 \textit{\$} 2-3.
\textsuperscript{156} For the requirement to obtain consent from all the other FIE parties, see Several Issues, supra note 3, art. 12.
\textsuperscript{157} See id. art. 21.
\textsuperscript{158} Id.
D. Nominee Structures

Foreign investors in China have often tried to circumvent the rather cumbersome restrictions on foreign investments in mainland China. One method used in this regard was the implementation of nominee structures. Here, the investor (the "Actual Investor") enters into a contract (the "Nominee Contract") with another party who agrees to become the legal holder of FIE equity interest (the "Nominee") but will be restricted to exercise her respective rights in the interest of the Actual Investor and subject to what is agreed in the Nominee Contract. Nominee structures have been used by foreign investors, e.g., for investments in industries where foreign investments are restricted or prohibited. The SPC Regulations now provide at least seven provisions addressing different issues related to Nominee Contracts.

Under the SPC Regulations, while the Actual Investor cannot make any direct claims against the FIE on the basis of the Nominee Contract, Nominee Contracts are in principle valid between the Nominee and the Actual Investor. They are enforceable even without approval granted by the approval authority, unless they violate applicable laws or regulations of P.R.C. law. An Actual Investor can, however, request a court to confirm that he, and not the Nominee, is the FIE-party provided that (i) he has actually invested in the FIE, (ii) the other FIE parties recognize him as an FIE Party, and (iii) the FIE approval authority approves the Actual Investor becoming a FIE party.

While these clarifications are of great practical value, the devil is again in the details. In particular, it remains unclear if Nominee Contracts are void if they deviate from any laws and regulations, or only from those, which are regarded as generally mandatory. If it is the latter, practical problems will arise out of the fact that Chinese law fails to provide clear guidance as to which rules are to be regarded as mandatory and which are not.

V. General Observations and Final Remarks

The SPC Regulations clarify a number of important issues related to foreign investment activities in mainland China. Therefore, they must be welcomed as they improve predict-

161. Id.
164. Id. art. 17.
165. For the legal consequences of invalid Nominee Contracts, see id. arts. 18-20.
166. See id. arts. 15-16.
167. See id. art. 14.
168. For the difficulty to determine the mandatory character of laws and regulations, see Wolff 2008, supra note 32, at 1054.
ability. But, it was demonstrated that some of the stipulations of the SPC Regulations may lead to further questions thus making their implementation potentially difficult. The SPC Regulations will therefore not immediately eliminate all the existing problems that they try to address.

More importantly, the SPC Regulations cannot be regarded as a systematic attempt to streamline mainland China's investment law system. In fact, this result could not be expected from the SPC Regulations, which, although normative in nature, are only meant to interpret existing law or to facilitate its application.169 Likewise, the SPC Regulations cannot be seen as an indication or even evidence of new legislative trends. In particular, the SPC Regulations fail to reinforce hopes that the approval requirement for foreign investment projects on the Chinese Mainland will be given up in due course. One of the SPC Regulations' emphasis is on nothing else but problems arising out of cases that are lacking the required approval.170 These problems are not at all regarded as short-lived.

Finally, the SPC Regulations cannot solve the main problem of mainland China's investment law system, i.e., its multi-system approach.171 As explained in the previous sections, different rules are governing foreign direct investment and M&A projects in mainland China, depending on the nature of the investor(s), the nature of potential target enterprises, and the mode of investment. This multiplicity of different regimes within China's investment law system leads to many problems in practice due to the lack of transparency. The state of development of China's economic and legal reforms does, on the other hand, not only justify, but also calls for steps to unify China's investment law system by abolishing the existing multi-system legislation once and for all. Although the SPC Regulations have contributed nothing to achieve this goal, the good news is that foreign investment related problems have now attracted the interpretative attention of the SPC. Hopefully more action will follow soon, adding to clarity and predictability of China's investment law.

169. See supra Section IV(A).
170. See Several Issues, supra note 3, art. 9.